

Notes to Consolidated Financial Statements (continued)

Dollars in millions except per share amounts

currently estimates the transition obligation to be between \$2,600 and \$3,000, with a related deferred income tax benefit between \$900 and \$1,100.

In addition to the transition obligation, management estimates that recurring annual expense will be approximately two and one-half times the amount recognized in 1992. As the timing and extent of expense recognition within the ratemaking process in the Telephone Company's regulatory jurisdictions are uncertain, the future net income impact of Statement No. 106 cannot be determined.

Postemployment Benefits In November 1992, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 112, "Employers' Accounting for Postemployment Benefits" (Statement No. 112). Statement No. 112 requires accrual of postemployment benefits at the occurrence of an event that renders an employee inactive or, if the benefits ratably vest, over the vesting period. Under its benefit plans, the Corporation provides employees varying levels of disability pay, workers' compensation and medical benefits under specified circumstances. Statement No. 112 must be adopted by January 1, 1994, although earlier adoption is permitted.

The Corporation intends to adopt Statement No. 112 on January 1, 1993, and estimates that a liability of approximately \$100, with a related tax benefit of approximately \$35, will be accrued for existing postemployment benefit obligations at that time. Ongoing expense, which will vary according to actual claims experience, cannot be determined currently.

3. Income Taxes

The components of income tax expense are as follows:

	1992	1991	1990
Federal:			
Current	\$560.4	\$516.7	\$444.7
Deferred — net	.7	6.9	45.2
Amortization of investment tax credits	(72.9)	(87.4)	(89.1)
	488.2	436.2	400.8
State and local:			
Current	61.1	43.9	41.1
Deferred — net	18.7	7.6	(2.3)
	79.8	51.5	38.8
Total	\$568.0	\$487.7	\$439.6

The components of deferred federal income tax expense are as follows:

	1992	1991	1990
Depreciation and amortization	\$ 29.6	\$(13.8)	\$ 64.0
Employee benefits	(83.7)	(13.6)	(13.9)
Undistributed earnings from investments in equity affiliates	60.7	25.5	—
Other — net	4.1	8.8	(4.9)
Total	\$.7	\$ 6.9	\$ 45.2

A reconciliation of income tax expense and the amount computed by applying the statutory federal income tax rate (34 percent) to income before income taxes and extraordinary loss is as follows:

	1992	1991	1990
Taxes computed at federal statutory rate	\$635.7	\$559.0	\$523.9
Increase (decreases) in taxes resulting from:			
Amortization of investment tax credits over the life of the plant that gave rise to the credits	(72.9)	(87.4)	(89.1)
Excess deferred taxes due to rate change	(74.3)	(55.8)	(55.4)
Depreciation of telephone plant construction costs previously deducted for tax purposes — net	21.7	23.2	28.1
State and local income taxes — net of federal tax benefit	52.7	34.0	25.6
Other — net	5.1	14.7	6.5
Total	\$568.0	\$487.7	\$439.6

The Telephone Company does not provide deferred income taxes if its regulated rates to customers are based on taxes currently payable (flow-through treatment). The amounts of income tax timing differences for which deferred tax liabilities have not been provided were approximately \$319, \$383 and \$451 at December 31, 1992, 1991 and 1990, respectively. The timing differences accorded flow-through treatment result principally from portions of allowance for funds used during construction and certain taxes and payroll-related construction costs previously capitalized for financial statement purposes, but deducted immediately for income tax purposes.

In accordance with Accounting Principles Board Opinion No. 11, "Accounting for Income Taxes", the deferred tax accounts included in the Corporation's Consolidated Balance Sheets as of December 31, 1992, were calculated using income tax rates in effect at the time the assets and liabilities were established. The recorded liabilities (net of the deferred tax assets) may be different than the ultimate cash payments to be made at the corporate income tax rate scheduled to be in effect when the deferred tax liabilities are settled.

In February 1992, the FASB issued Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (Statement No. 109), which is effective beginning in 1993. Statement No. 109 requires a change to the liability method of accounting for income taxes and requires regulated companies, such as the Telephone Company, to record a regulatory asset and regulatory liability when adjusting their deferred income tax liability if certain criteria are met. Management estimates that substantially all of the net reduction in the Telephone Company's deferred tax liability of \$450 would be offset by the establishment of a regulatory liability and a regulatory asset with minimal effect on 1993 net income.

Management estimates that implementation of Statement No. 109 on a consolidated basis will result in a one-time charge in 1993 of between \$185 and \$220 to establish a deferred tax liability associated with certain prior acquisitions not related to the Telephone Company. Absent any change in statutory federal income tax rates or laws, the Corporation's future income tax expense, computed according to Statement No. 109 provisions, will not be materially different from income tax expense currently recognized in the Corporation's financial statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Dollars in millions except per share amounts

\$34 were implemented in 1992, and additional rate reductions of approximately \$23 and \$102 will be implemented in 1993 and 1994, respectively.

The Agreement also provides an earnings-sharing mechanism designed to encourage efficiency and innovation by the Telephone Company. The sharing amounts for the first and second plan years were accrued in 1991 and 1992, respectively. Reductions in revenues due to sharing did not have a material impact on the Corporation's financial results in 1992 or 1991.

In 1991, the Agreement was appealed to the District Court of Travis County, Texas, by various intervenors. On December 10, 1991, the District Court issued an order which affirmed the decision of the TPUC and denied all appeals. The same intervenors filed further appeals with the Texas Court of Appeals (Appeals Court). On February 3, 1993, the Appeals Court upheld the Agreement. However, the Appeals Court found that the TPUC incorrectly applied laws on the treatment of federal income tax savings related to disallowed expenses and directed the matter back to the TPUC for resolution. The Telephone Company will seek a rehearing on this issue.

On October 7, 1992, the Office of Public Utility Counsel (OPUC) filed a petition for inquiry into the rates of the Telephone Company alleging that unforeseen and unusual events have occurred since the TPUC approved the Agreement. OPUC alleges that the Telephone Company has realized reductions in its cost of service and an increase in revenues, resulting in excess annual earnings of approximately \$234, which the sharing mechanism failed to capture. OPUC has requested the TPUC to conduct a hearing to establish just and reasonable rates. The Telephone Company filed a motion to dismiss on November 4, 1992. At a November 9, 1992, prehearing conference, the administrative law judge abated discovery pending issuance of an order on the Telephone Company's motion. A ruling on the motion is expected during the first or second quarter of 1993. The OPUC petition did not have an impact on 1992 financial results. Until the full scope of this proceeding is determined, an estimate of any future impact on financial results cannot be made. However, at this time, management does not believe any material financial impact will result.

Postretirement Benefits Other Than Pensions The adoption of Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (Statement

No. 106), for ratemaking purposes is currently being addressed by regulatory authorities in most of the Telephone Company's state jurisdictions. Proceedings on this matter are in various stages. An order was issued by the MPSC on January 12, 1993, which indicates that the Telephone Company should continue to account for postretirement benefits for ratemaking purposes under the current cash basis. The Telephone Company plans to file a motion for rehearing on this matter. Management cannot estimate the potential expense recovery, if any, for accrued postretirement benefits for its five-state area at this time.

In 1990, the FCC adopted rules to begin price-cap regulation effective January 1, 1991, for interstate telecommunications services offered by the local exchange carriers, including the Telephone Company. Price-cap regulation shifts the focus of regulation to prices rather than earnings and costs. Prices for most interstate services are capped, and the cap will be adjusted annually for changes in inflation, productivity and other factors.

In December 1991, the FCC issued an order requiring all local exchange carriers to adopt Statement No. 106 effective January 1, 1993, for interstate regulatory accounting and prescribed the amortization method for recognition of the transition obligation. On June 1, 1992, the Telephone Company filed with the FCC a request to increase its price caps for the incremental interstate costs resulting from the accrual accounting required by Statement No. 106 (exogenous treatment). On January 22, 1993, the FCC issued an order denying exogenous treatment for these incremental costs stating that the local exchange carriers had not met the burden of proof that these costs were beyond their control. However, the FCC did not preclude the seeking of exogenous treatment of the accumulated postretirement benefit obligation which exists at the date of adoption in a separate filing in 1993.

Competition

Interstate On October 19, 1992, the FCC released an order that allows independent parties, including, but not limited to, competitive access providers (CAPs), interexchange carriers and end users to physically collocate their equipment within the major local exchange carriers' central offices, or to designate carrier-provided central office equipment to be dedicated to their use (virtual collocation) for the provision of special access services. The interconnecting parties are required to pay for the intercon-

SFAS-106 Actuarial Valuation

**(contains description of
benefits covered by SFAS-106)**

Towers Perrin

April 20, 1993

Mr. Gregory D. Woods
Assistant Director —
Accounting Research
Southwestern Bell Corporation
One Bell Center, #39-U-07
St. Louis, Missouri 63101

Dear Greg:

Actuarial valuations as of January 1, 1993 of the postretirement welfare benefits for current and former employees of Southwestern Bell Corporation (SBC) have been completed. Separate reports for health benefits, dental benefits, basic life insurance benefits and telephone concessions are included under separate tabs of this binder.


The valuations have been performed in accordance with the requirements of Financial Accounting Standard No. 106. The selection of assumptions and format of results have been jointly defined by SBC and Towers Perrin.

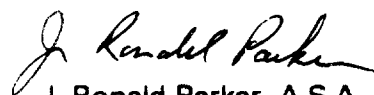
The magnitude of these benefit commitments are substantial, as is indicated in attached Table A. The table presents a 20-year projection of SBC liabilities and expense for the combined health (capped basis), dental, life insurance, and telephone concessions programs. The expense amounts shown reflect SBC's decision to adopt FAS 106 in 1993 with immediate recognition of the transition obligation.

The health care report also summarizes the liabilities and expense of the plan as if no caps on benefits existed. Table B presents a 20-year projection of liabilities and expense for the combined programs reflecting this basis.

We are available to discuss the contents of these reports with you at your convenience.

Sincerely,


Joseph M. Vogl, F.S.A., M.A.A.A.
Vice President


J. Ronald Parker, A.S.A., M.A.A.A.
Principal

JMV/JRP:slp
35575:A1.93:C

Enclosures

Table A

SBC 1993 POSTRETIREMENT WELFARE BENEFITS VALUATION
Basic Valuation Results – All Benefits – Total Corporation
with \$5,500 Defined Dollar and Medicare Part B Reimbursement Caps
(\$000)

<u>Year</u>	<u>Claims</u>	<u>EPBO</u>	<u>APBO</u>	<u>Assets</u>	<u>Service Cost</u>	<u>Expense</u>	<u>Expense as % of Payroll</u>
1993	\$144,411	\$3,540,332	\$3,110,009	\$290,464	\$48,124	\$247,858 *	3.1%
1994	\$155,479	\$3,663,017	\$3,245,262	\$461,387	\$49,794	\$245,723	3.0%
1995	\$165,430	\$3,784,907	\$3,380,989	\$645,822	\$50,564	\$241,615	2.8%
1996	\$176,238	\$3,907,031	\$3,517,399	\$845,013	\$51,778	\$245,857	2.8%
1997	\$188,452	\$4,028,429	\$3,654,137	\$898,837	\$51,729	\$251,316	2.8%
1998	\$201,010	\$4,147,598	\$3,788,415	\$956,618	\$51,576	\$256,156	2.7%
1999	\$214,526	\$4,264,182	\$3,919,575	\$1,018,488	\$48,769	\$257,555	2.6%
2000	\$229,598	\$4,377,352	\$4,043,536	\$1,084,710	\$46,577	\$258,673	2.6%
2001	\$246,261	\$4,485,624	\$4,158,820	\$1,155,428	\$45,175	\$259,572	2.5%
2002	\$263,003	\$4,586,964	\$4,263,969	\$1,230,954	\$43,992	\$259,578	2.4%
2003	\$279,140	\$4,680,970	\$4,358,379	\$1,311,549	\$42,711	\$258,276	2.4%
2004	\$295,269	\$4,767,713	\$4,441,745	\$1,397,565	\$40,861	\$255,116	2.3%
2005	\$311,284	\$4,847,020	\$4,512,665	\$1,489,319	\$38,002	\$249,480	2.2%
2006	\$325,791	\$4,918,340	\$4,569,224	\$1,587,205	\$38,639	\$246,094	2.1%
2007	\$339,409	\$4,982,412	\$4,615,668	\$1,691,661	\$36,264	\$238,220	2.0%
2008	\$352,116	\$5,039,543	\$4,648,919	\$1,803,181	\$37,325	\$232,518	1.9%
2009	\$363,572	\$5,089,981	\$4,672,630	\$1,922,270	\$36,734	\$223,771	1.7%
2010	\$374,795	\$5,134,580	\$4,685,608	\$2,049,845	\$36,838	\$214,295	1.6%
2011	\$384,577	\$5,173,105	\$4,688,027	\$2,185,855	\$38,456	\$205,034	1.5%
2012	\$392,449	\$5,206,010	\$4,682,226	\$2,331,379	\$40,671	\$195,104	1.4%

* Excludes Net Transition Obligation expense of \$ 2,819,545,000 taken in 1993

Table B

SBC 1993 POSTRETIREMENT WELFARE BENEFITS VALUATION
Basic Valuation Results—All Benefits—Total Corporation
without Defined Dollar or Medicare Part B Reimbursement Caps
(\$000)

<u>Year</u>	<u>Claims</u>	<u>FPBO</u>	<u>APBO</u>	<u>Assets</u>	<u>Service Cost</u>	<u>Expense</u>	<u>Expense as % of Payroll</u>
1993	\$144,411	\$6,422,279	\$5,048,311	\$290,464	\$142,852	\$495,063 *	6.3%
1994	\$155,808	\$6,786,803	\$5,430,768	\$461,387	\$150,275	\$517,641	6.3%
1995	\$167,393	\$7,174,736	\$5,838,083	\$645,822	\$155,758	\$538,906	6.3%
1996	\$179,874	\$7,587,751	\$6,269,822	\$845,013	\$162,401	\$571,075	6.5%
1997	\$194,591	\$8,026,667	\$6,728,144	\$898,837	\$165,668	\$604,127	6.6%
1998	\$212,245	\$8,491,666	\$7,209,092	\$956,618	\$168,866	\$638,379	6.8%
1999	\$233,017	\$8,982,697	\$7,711,245	\$1,018,488	\$164,515	\$665,676	6.8%
2000	\$258,425	\$9,501,191	\$8,224,839	\$1,084,710	\$161,496	\$694,746	6.9%
2001	\$289,511	\$10,046,794	\$8,747,367	\$1,155,428	\$161,087	\$726,727	7.0%
2002	\$325,059	\$10,616,525	\$9,276,425	\$1,230,954	\$161,745	\$759,809	7.1%
2003	\$364,398	\$11,209,133	\$9,809,013	\$1,311,549	\$162,058	\$792,234	7.2%
2004	\$409,041	\$11,823,231	\$10,341,078	\$1,397,565	\$160,785	\$822,295	7.3%
2005	\$459,049	\$12,457,902	\$10,865,404	\$1,489,319	\$155,680	\$847,000	7.3%
2006	\$511,146	\$13,109,228	\$11,371,718	\$1,587,205	\$164,463	\$884,716	7.5%
2007	\$567,591	\$13,775,546	\$11,871,427	\$1,691,661	\$161,438	\$908,562	7.5%
2008	\$626,657	\$14,453,920	\$12,346,837	\$1,803,181	\$173,052	\$945,661	7.6%
2009	\$685,859	\$15,141,727	\$12,809,146	\$1,922,270	\$178,139	\$974,152	7.6%
2010	\$748,574	\$15,841,225	\$13,250,219	\$2,049,845	\$187,428	\$1,004,762	7.6%
2011	\$809,546	\$16,549,539	\$13,669,323	\$2,185,855	\$203,752	\$1,040,677	7.7%
2012	\$860,711	\$17,265,908	\$14,074,194	\$2,331,379	\$223,683	\$1,078,997	7.7%

* Excludes Net Transition Obligation expense of \$ 4,757,847,000

Health Benefits

SOUTHWESTERN BELL CORPORATION

**ACTUARIAL VALUATION OF
POSTRETIREMENT HEALTH BENEFITS**

**TOWERS PERRIN
101 SOUTH HANLEY
ST. LOUIS, MISSOURI 63105**

APRIL 1993

TABLE OF CONTENTS

	<u>Page</u>
SECTION I INTRODUCTION	1
SECTION II ACTUARIAL VALUATION RESULTS	3
Table A Basic Valuation Results - Capped* Benefits	9
Table B Basic Valuation Results - Uncapped** Benefits	10
Table C Projected Plan Participation	11
Table D Defined Dollar Analysis	12
SECTION III SENSITIVITY OF RESULTS	13
Table E Sensitivity Results - Capped Benefits	15
Table F Sensitivity Results - Uncapped Benefits	16
SECTION IV SUMMARY OF PLAN PROVISIONS	17
SECTION V SUMMARY OF PARTICIPANT AND CLAIMS DATA	30
Table G Active Participant Summary	33
Table H Retired Participant Summary	36
Table I Participants by Corporate Entity	39
SECTION VI SUMMARY OF ACTUARIAL METHOD	40
SECTION VII SUMMARY OF ACTUARIAL ASSUMPTIONS	41
 APPENDICES	
A1-A11 Basic Valuation Results By Subsidiary - Capped Benefits	
B1-B11 Basic Valuation Results By Subsidiary - Uncapped Benefits	
C 1993 Liability Breakdown - Capped Benefits	
D 1993 Liability Breakdown - Uncapped Benefits	
 * With Defined Dollar and Medicare Part B Reimbursement Caps	
** Without Defined Dollar and Medicare Part B Reimbursement Caps	

SECTION I -- INTRODUCTION

Southwestern Bell Corporation (SBC) currently provides health care benefits to retirees and dependents of SBC, Southwestern Bell Telephone Company, Southwestern Bell Yellow Pages, Inc., Southwestern Bell Telecommunications, Inc. and several other subsidiaries. To qualify, an employee must retire under the early, normal or late retirement provisions of the Southwestern Bell Corporation Management Pension Plan, Southwestern Bell Corporation Pension Plan, or applicable subsidiary plan.

With the exception of Associated Directory Services and Mobile Systems, current retirees are not required to contribute toward the cost of these benefits; the entire cost is borne by Southwestern Bell Corporation. Future retirees will increasingly bear the cost of these benefits if the defined dollar caps on benefits, introduced in 1989, are not raised. AT&T annually reimburses SBC for the health benefits of certain pre-divestiture retirees covered under the Unfunded Benefits Cost Sharing Agreement and the 1983 Force Adjustment Cost Reimbursement and Indemnification Agreement. The net cost has been funded and expensed on a pay-as-you-go basis.

In December 1990, the Financial Accounting Standards Board issued Financial Accounting Statement No. 106 (FAS 106), **Employers' Accounting for Postretirement Benefits Other Than Pensions**. FAS 106 requires employers, beginning in 1993, to expense postretirement welfare benefits on an accrual basis similar to that required for pension plans.

The purposes of this actuarial study are to quantify the magnitude of SBC's overall liability for postretirement health benefits and to identify the effect of adopting FAS 106 on SBC's income statement. The results of the study have been prepared and presented so that attention may be focused on the following:

- Liabilities with and without benefit caps
- Liabilities by operating company/subsidiary
- Liabilities for current versus future retirees

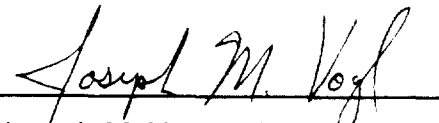
■ Liabilities for management employees versus nonmanagement employees

The results of this study reflect SBC's decision to adopt FAS 106 in 1993 with full immediate recognition of the transition obligation.

Supporting Documentation

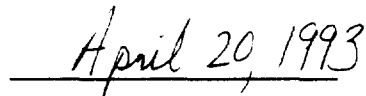
The present study has been based upon the health benefit plan provisions briefly summarized in Section IV. Participant and claims information provided by SBC are summarized in Section V. While the information provided has been reviewed for reasonableness, no attempt has been made to audit such information.

The specific actuarial methodology and assumptions underlying this study are presented in Sections VI and VII. We believe the contents of this study comply with the Actuarial Standards Board's actuarial compliance guidelines with respect to FAS 106.



Joseph M. Vogl, F.S.A., M.A.A.A.

Vice President



J. Ronald Parker, A.S.A., M.A.A.A.

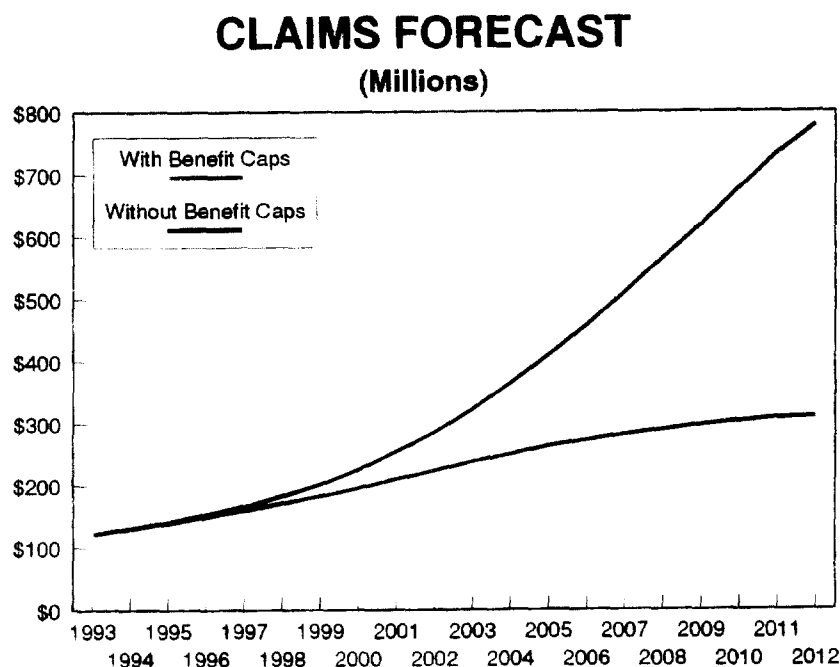
Principal

SECTION II -- ACTUARIAL VALUATION RESULTS

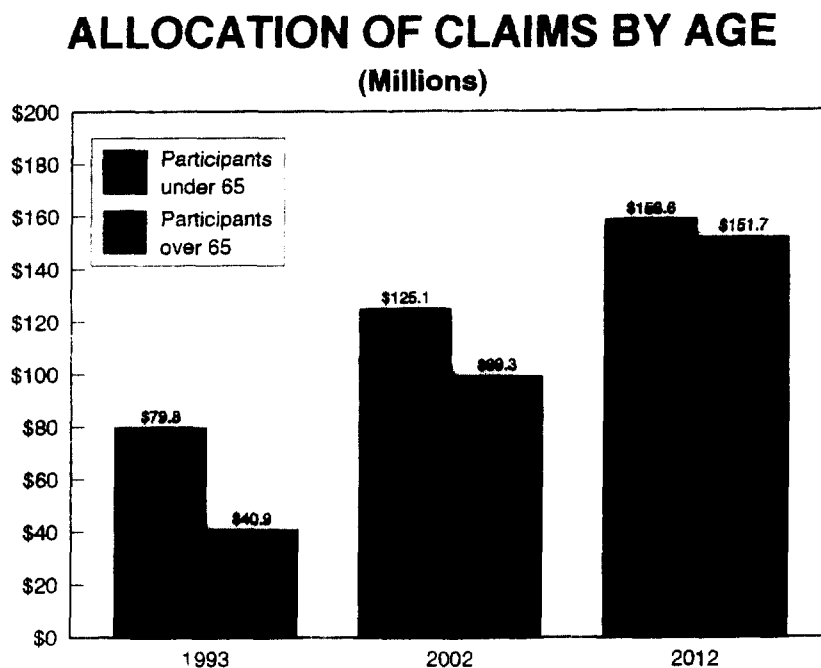
Postretirement health care claims, liabilities and expense levels were projected for the 20-year period 1993 through 2012. Total corporation results are presented in Table A, while breakdowns by various corporate entities are presented in Appendices A1 through A11. For comparative purposes, results also were determined ignoring the effect of (i) the defined dollar caps effective for retirements occurring on or after September 1, 1992 (November 1, 1992 for Yellow Pages and Telecommunications); and (ii) the current Medicare Part B premium reimbursement limit of \$40 per month (\$50 for Yellow Pages and Mobile Systems). These results are presented in Table B and in Appendices B1 through B11. Projected plan participation over the forecast period is summarized in Table C.

Claims

Health care claims are shown net of estimated AT&T reimbursements on an accrual basis but including administrative expenses. Uncapped claims are expected to increase over the 20-year forecast period, from \$120.7 Million in 1993 to \$286.5 Million in the year 2002 and \$778.5 Million in 2012. Claims payable by SBC under the capped plan will also increase over the forecast period, but to a much lesser extent: from \$120.7 Million in 1993 to \$224.4 Million in the year 2002 and \$310.3 Million in 2012. The following graph illustrates the effect of the benefit caps on SBC-provided claims over the forecast period:



During 1993, 66% of all net postretirement health benefits are expected to be received by retirees or dependents under age 65. Under the capped plan, this percentage will decrease steadily in future years, as illustrated in the following chart:



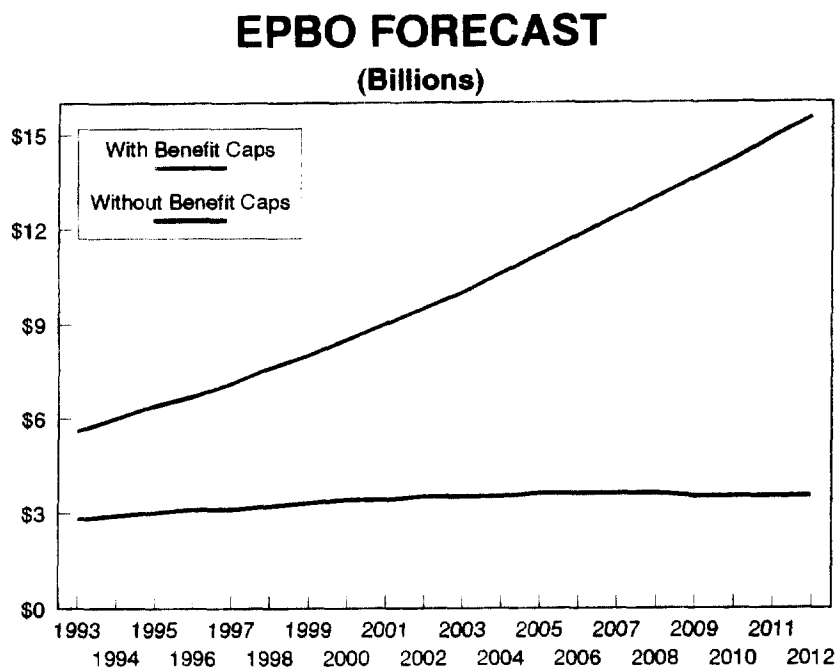
Under the capped plan, currently retired participants and their dependents will represent 68% of the total paid claims in the year 2002 and 40% in the year 2012.

Expected Postretirement Benefit Obligation

The Expected Postretirement Benefit Obligation (EPBO) in any year represents the full actuarial present value of postretirement benefits, including administrative expenses, for all active and retired employees (and their dependents) at that time.

As of January 1, 1993, the total actuarial liability for uncapped postretirement health care benefits for SBC is \$5.7 Billion. This EPBO is expected to grow to \$9.5 Billion in the year 2002 and \$15.5 Billion in the year 2012. Under the capped plan, the EPBO will grow from \$2.8 Billion in 1993 to \$3.5 Billion in the year 2002. It will increase slightly over the next five years, but then gradually decrease back to \$3.5 Billion in the year 2012.

The following graph compares the EPBOs for both capped and uncapped benefits over the forecast period:



Under the capped plan, 50% of the 1993 EPBO is for claims that will be incurred prior to age 65. Currently retired participants and their dependents account for 60% of the total 1993 capped liability.

Accumulated Postretirement Benefit Obligation

The Accumulated Postretirement Benefit Obligation (APBO) represents that portion of the total liability assigned prior to the valuation year by FAS 106. The liability for current retirees (and dependents) and active employees eligible to retire or terminate with full benefits is fully reflected in the APBO. The liability for active employees not yet eligible to retire with full benefits is included in the APBO based upon the ratio of the number of completed years of service to the number of years of service that will be completed when the employee satisfies the eligibility requirements for full benefits.

As of January 1, 1993, the APBO for uncapped benefits is \$4.4 Billion while the APBO under the capped plan is \$2.5 Billion. With respect to the APBO for the capped plan, 48% represents claims that will be incurred prior to age 65.

The APBO as of January 1, 1993 represents the Transition Obligation under FAS 106. SBC has elected full immediate recognition of the Transition Obligation in 1993 expense. This results in substantially greater expense in 1993 but reduced expense levels in subsequent years.

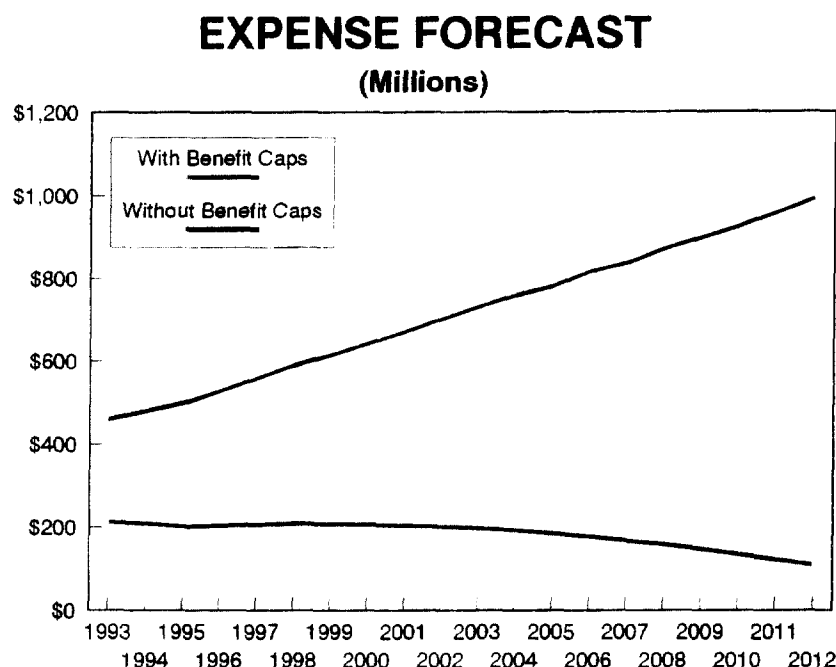
Expense

FAS 106 expense is the sum of several individual components: (1) service cost -- the cost of benefits being earned in the current fiscal period; (2) interest on the Accumulated Postretirement Benefit Obligation and Service Cost; (3) interest credited on any accumulated plan assets; (4) amortization of gains and losses or plan amendments; and (5) for 1993 only, the Transition Obligation.

Expense for 1993 for the capped plan is \$2.7 Billion, while expense for uncapped benefits would be \$4.9 Billion. The effect of immediate recognition of the Transition Obligation on 1993 expense is as follows:

	(millions)	
	<u>Capped Benefits</u>	<u>Uncapped Benefits</u>
■ Expense before Transition Obligation	\$ 212.5	\$ 459.7
■ Transition Obligation	<u>\$2,511.2</u>	<u>\$4,449.5</u>
■ Total Expense	\$2,723.7	\$4,909.2

The following graph compares the annual expense levels over the forecast period with and without the benefit caps and excluding the effects of the Transition Obligation in 1993 expense:



Defined Dollar Analysis

The effect of the defined dollar caps will be to shift health care costs from SBC to the affected retiree group -- those retiring on or after September 1, 1992 (November 1, 1992 for Yellow Pages and Telecommunications). This cost shifting effect is illustrated in Table D, which splits the projected total health claims between the non-defined dollar and defined dollar retiree groups. For the latter group, the expected total retiree cost in each year has been determined as the excess of the total cost over SBC's aggregate defined dollar commitment. The average retiree cost was then determined by dividing the total retiree cost by the expected number of defined dollar retirees.

The average monthly defined dollar retiree cost is expected to gradually increase from \$13 per retiree in 1997 to \$1,150 per retiree in the year 2012.

1993 Liability Breakdown

Breakdowns of the 1993 liability results between management and nonmanagement employees and between active and retired employees are presented in Appendix C for capped benefits and Appendix D for uncapped benefits.

Table A

SBC POSTRETIREMENT HEALTH BENEFITS VALUATION
Basic Valuation Results – Total Corporation
with \$5,500 Defined Dollar and Medicare Part B Reimbursement Caps
(\$000)

<u>Year</u>	<u>Claims</u>	<u>EPBO</u>	<u>APBO</u>	<u>Assets</u>	<u>Service Cost</u>	<u>Expense</u>	<u>Expense as % of Payroll</u>
1993	\$120,731	\$2,799,976	\$2,511,239	\$0	\$34,996	\$212,487 *	10.3%
1994	130,258	2,889,206	2,612,026	161,032	35,978	207,868	9.8%
1995	139,309	2,976,090	2,711,554	334,946	36,163	201,286	9.1%
1996	149,095	3,060,889	2,809,355	522,773	36,729	202,873	8.8%
1997	160,141	3,142,599	2,904,957	564,595	36,224	205,747	8.7%
1998	171,270	3,219,685	2,995,733	609,762	35,653	207,919	8.5%
1999	183,098	3,291,759	3,081,162	658,543	32,921	207,052	8.1%
2000	196,061	3,357,933	3,157,796	711,226	30,776	205,801	7.8%
2001	210,385	3,416,736	3,224,437	768,125	29,276	204,107	7.5%
2002	224,417	3,466,198	3,279,608	829,575	27,988	201,430	7.2%
2003	237,569	3,505,956	3,322,987	895,941	26,637	197,435	6.9%
2004	250,297	3,536,172	3,354,527	967,616	24,869	191,698	6.5%
2005	262,569	3,556,719	3,373,340	1,045,025	22,332	183,736	6.1%
2006	273,017	3,567,258	3,378,110	1,128,627	22,515	177,220	5.7%
2007	282,307	3,568,749	3,372,604	1,218,917	20,361	166,925	5.3%
2008	290,390	3,561,667	3,354,735	1,316,430	20,825	157,984	4.8%
2009	297,007	3,546,459	3,327,646	1,421,745	19,988	146,385	4.4%
2010	303,071	3,524,081	3,290,762	1,535,484	19,665	133,947	3.9%
2011	307,652	3,494,479	3,244,482	1,658,323	20,383	121,253	3.4%
2012	310,254	3,458,369	3,190,749	1,790,988	21,472	107,686	2.9%

* Excludes Transition Obligation expense of \$ 2,511,239,000 taken in 1993

Table B

SBC POSTRETIREMENT HEALTH BENEFITS VALUATION
Basic Valuation Results – Total Corporation
without Defined Dollar or Medicare Part B Reimbursement Caps
(\$000)

<u>Year</u>	<u>Claims</u>	<u>EPBO</u>	<u>APBO</u>	<u>Assets</u>	<u>Service Cost</u>	<u>Expense</u>	<u>Expense as % of Payroll</u>
1993	\$120,731	\$5,681,923	\$4,449,541	\$0	\$129,724	\$459,692 *	22.4%
1994	130,587	6,012,992	4,797,532	161,032	136,459	479,786	22.5%
1995	141,272	6,365,919	5,168,648	334,946	141,357	498,577	22.5%
1996	152,731	6,741,609	5,561,778	522,773	147,352	528,091	23.0%
1997	166,280	7,140,837	5,978,964	564,595	150,163	558,558	23.5%
1998	182,505	7,563,753	6,416,410	609,762	152,943	590,142	24.0%
1999	201,589	8,010,274	6,872,832	658,543	148,667	615,173	24.2%
2000	224,888	8,481,772	7,339,099	711,226	145,695	641,874	24.4%
2001	253,635	8,977,906	7,812,984	768,125	145,188	671,262	24.8%
2002	286,473	9,495,759	8,292,064	829,575	145,741	701,661	25.2%
2003	322,827	10,034,119	8,773,621	895,941	145,984	731,393	25.5%
2004	364,069	10,591,690	9,253,860	967,616	144,793	758,877	25.8%
2005	410,334	11,167,601	9,726,079	1,045,025	140,010	781,256	25.9%
2006	458,372	11,758,146	10,180,604	1,128,627	148,339	815,842	26.3%
2007	510,489	12,361,883	10,628,363	1,218,917	145,535	837,267	26.3%
2008	564,931	12,976,044	11,052,653	1,316,430	156,552	871,127	26.7%
2009	619,294	13,598,205	11,464,162	1,421,745	161,393	896,766	26.8%
2010	676,850	14,230,726	11,855,373	1,535,484	170,255	924,414	26.8%
2011	732,621	14,870,913	12,225,778	1,658,323	185,679	956,896	27.0%
2012	778,516	15,518,267	12,582,717	1,790,988	204,484	991,579	27.1%

* Excludes Transition Obligation expense of \$ 4,449,541,000

Table C

SBC POSTRETIREMENT HEALTH BENEFITS VALUATION
Projected Plan Participation – Total Corporation

<u>Jan 1</u>	<u>Active</u>	<u>Under 65</u>	<u>Retired</u> <u>Over 65</u>	<u>Total</u>	<u>Under 65</u>	<u>Retired Spouses</u> <u>Over 65</u>	<u>Total</u>
<u>MANAGEMENT</u>							
1993	17,274	6,506	5,119	11,625	5,435	2,607	8,042
1997	17,274	4,911	5,968	10,879	3,932	3,339	7,271
2002	17,274	4,740	6,295	11,035	3,535	3,649	7,184
2012	17,274	5,370	8,683	14,053	4,393	4,638	9,031
<u>NONMANAGEMENT</u>							
1993	39,803	6,969	12,938	19,907	5,094	6,367	11,461
1997	39,803	5,013	14,617	19,630	3,412	7,620	11,032
2002	39,803	6,095	14,790	20,885	4,258	7,409	11,667
2012	39,803	11,252	16,434	27,686	7,968	8,133	16,101
<u>COMBINED</u>							
1993	57,077	13,475	18,057	31,532	10,529	8,974	19,503
1997	57,077	9,924	20,585	30,509	7,344	10,959	18,303
2002	57,077	10,835	21,085	31,920	7,793	11,058	18,851
2012	57,077	16,622	25,117	41,739	12,361	12,771	25,132

Table D

SBC POSTRETIREMENT HEALTH BENEFITS VALUATION
Defined Dollar Cap Analysis

Year	Claims – Non – DDB Retirees *	Claims – Defined Dollar Retirees				Monthly Cost Per Retiree ***
		Total *	Employer Paid *	Retiree Paid *	Number of Retirees **	
1993	\$119,216	\$1,515	\$1,515	\$0	254	\$0
1994	125,109	5,149	5,149	0	776	0
1995	129,448	9,861	9,861	0	1,348	0
1996	133,240	15,855	15,855	0	1,993	0
1997	137,058	23,502	23,083	419	2,736	13
1998	140,889	33,579	30,381	3,198	3,603	74
1999	144,144	46,812	38,954	7,858	4,664	140
2000	146,875	64,488	49,186	15,302	5,973	213
2001	149,894	87,099	60,491	26,608	7,485	296
2002	151,918	114,489	72,499	41,990	9,146	383
2003	152,707	146,331	84,862	61,469	10,926	469
2004	152,620	183,660	97,677	85,983	12,846	558
2005	151,667	226,582	110,902	115,680	14,902	647
2006	149,206	272,505	123,811	148,694	16,993	729
2007	145,903	322,858	136,404	186,454	19,073	815
2008	142,286	375,468	148,104	227,364	21,111	897
2009	138,122	427,856	158,885	268,971	23,098	970
2010	133,911	482,895	169,160	313,735	25,046	1,044
2011	129,314	535,898	178,338	357,560	26,870	1,109
2012	124,606	578,636	185,648	392,988	28,485	1,150

* \$000

** Represents retirees at beginning of year plus retirements during year.

*** Monthly cost calculated reflecting full year of exposure for retirees as of beginning of year and one – half year exposure for retirements during the year.

SECTION III -- SENSITIVITY OF RESULTS

Estimates of the liability and expense for postretirement health benefits are sensitive to a number of assumptions, of which the following are perhaps most significant:

Discount Rate. The discount rate is used to adjust future expected benefit payments to the current measurement date to reflect the time value of money. The discount rate used in Section II corresponds to the rate currently in effect for pension expense purposes. An increase in the discount rate would result in lower liabilities and expense.

Health Care Trend Rate. The health care trend rate is used to anticipate per capita increases in health costs. Components of health care trend include inflation, cost-shifting, technology advances and utilization increases. The health care trend rate used in Section II is not a flat rate but a pattern of rates. For example, the trend rate for benefits paid prior to age 65 begins at 12% for 1993 and decreases by 50 basis points each year until it reaches 6% in the year 2005. It is held constant at 6% per year throughout the remainder of the valuation period.

Over the last several years, health cost increases have far exceeded general economic growth rates; however, it is generally believed that this phenomenon will not continue indefinitely and that, over time, health care cost increases will approach those of the general economy. Using the base case health care trend rates and assuming 5.5% per year GDP growth, health care costs would increase from its estimated current 14.4% share of GDP to 21.0% by the year 2012 and 22.4% by the year 2025.

Tables E and F review the valuation results for 1993 assuming an 8.5% discount rate in place of the 7.5% discount rate used in Section II and also assuming a 1% increase in the annual health trend rates used in Section II. The following table summarizes the changes in the liability and expense results reflecting the capped benefits (figures may vary from those in Table E due to rounding):

Change in Discount Rate

(millions)

	<u>7.5%</u>	<u>8.5%</u>	<u>Percentage Change</u>
Expected Postretirement Benefit Obligation	\$ 2,800	\$2,471	(11.8)%
Accumulated Postretirement Benefit Obligation	\$ 2,511	\$2,238	(10.9)%
Expense: Transition Obligation	\$ 2,511	\$2,238	(10.9)%
Ongoing Cost	\$ 212.5	\$207.6	(2.3)%

Change in Health Trend Rates

(millions)

	<u>Current Rates</u>	<u>Adjusted Rates</u>	<u>Percentage Change</u>
Expected Postretirement Benefit Obligation	\$ 2,800	\$2,960	5.7%
Accumulated Postretirement Benefit Obligation	\$ 2,511	\$2,670	6.3%
Expense: Transition Obligation	\$ 2,511	\$2,670	6.3%
Ongoing Cost	\$ 212.5	\$224.5	5.6%

Table E

SBC POSTRETIREMENT HEALTH BENEFITS VALUATION
1993 Sensitivity Results—Total Corporation
with \$5,500 Defined Dollar and Medicare Part B Reimbursement Caps
(\$000)

	Base Results	Discount Rate Change 1% Increase	% Change	Trend Rate Change 1% Increase	% Change
Claims	\$120,731	\$120,731	0.0%	\$120,731	0.0%
EPBO	2,799,976	2,470,808	-11.8%	2,959,769	5.7%
<u>APBO</u>					
Retirees	1,691,067	1,538,975	-9.0%	1,848,299	9.3%
Fully eligible active participants	185,621	168,446	-9.3%	186,136	0.3%
Other active participants	<u>634,551</u>	<u>530,912</u>	-16.3%	<u>635,336</u>	0.1%
Total	2,511,239	2,238,333	-10.9%	2,669,771	6.3%
Assets	0	0	0.0%	0	0.0%
Service Cost	34,996	28,973	-17.2%	35,106	0.3%
<u>Expense</u>					
Transition Obligation	2,511,239	2,238,333	-10.9%	2,669,771	6.3%
Ongoing Cost	212,487	207,636	-2.3%	224,495	5.7%

Table F

SBC POSTRETIREMENT HEALTH BENEFITS VALUATION
1993 Sensitivity Results—Total Corporation
without Defined Dollar or Medicare Part B Reimbursement Caps
(\$000)

	<u>Base Results</u>	<u>Discount Rate Change</u> <u>1% Increase</u>	<u>% Change</u>	<u>Trend Rate Change</u> <u>1% Increase</u>	<u>% Change</u>
Claims	\$120,731	\$120,731	0.0%	\$120,731	0.0%
EPBO	5,681,923	4,746,642	-16.5%	6,868,312	20.9%
<u>APBO</u>					
Retirees	1,854,213	1,679,063	-9.4%	2,050,190	10.6%
Fully eligible active participants	371,425	325,157	-12.5%	425,672	14.6%
Other active participants	<u>2,223,903</u>	<u>1,787,772</u>	-19.6%	<u>2,785,775</u>	25.3%
Total	4,449,541	3,791,992	-14.8%	5,261,637	18.3%
Assets	0	0	0.0%	0	0.0%
Service Cost	129,724	103,079	-20.5%	164,667	26.9%
<u>Expense</u>					
Transition Obligation	4,449,541	3,791,992	-14.8%	5,261,637	18.3%
Ongoing Cost	459,692	420,102	-8.6%	558,163	21.4%